

IHCDA Real Estate Department

Asset Management Data Collection: Results and Next Steps

October 2013

I: Background

Every active rental property in IHCDA's Real Estate Department portfolio is required to submit an Annual Owner Certification of Compliance. This report is due each year by January 31st to report on program compliance for the previous calendar year. Historically, the information gathered has been limited to issues of program compliance such as rent and income data to ensure that program limits regarding affordability are being followed. Beginning with the 2011 Owner Certification, IHCDA implemented a new form entitled "Exhibit D: Asset Management" to gather limited financial and performance indicators for each property.

For 2012 Exhibit D contained thirteen questions. Each response provides a "snapshot" view of the property as of calendar year end 2012 (12/31/12). For 2012, data was analyzed on 599 low-income housing tax credit properties and 124 HOME or CDBG funded rental properties (no low-income housing tax credits involved). Each submission did not, however, necessarily answer every question. Quality of data, both in regards to completeness and accuracy, continues to be a concern. This will be addressed later in the report.

II: Data Summary

Below is a summary of the results from each of the thirteen questions, broken down by program type and compared to the previous year's (2011) data where applicable. The numbers listed represent the average figure across the sample size. Note: As stated above, IHCDA is aware that there are issues regarding the accuracy of data reported. Therefore, caution must be exercised when interpreting the data below.

The sample size significantly increased from 2011 to 2012. In 2011 only 420 tax Credit properties were included in the dataset, while there are 599 properties included in the 2012 set. Similarly, the dataset for HOME and CDBG properties increased from 84 to 124.

Between the 2011 and 2012 Owner Certifications, the Exhibit D form was edited. The 2012 form was updated to include definitions for the first seven questions and to add a new question about net operating income/loss. Therefore, comparisons cannot be made between 2011 and 2012 for that question (Question #4).

Additionally, when the 2011 data was compiled into a master spreadsheet, the answers to the qualitative questions (Questions #8-13) that required a yes or no response were not input. Therefore, comparisons cannot be made between 2011 and 2012 for these questions. IHCDA is now coding those responses to allow comparisons in future years.

Question 1: Physical Vacancy Rate of Development

LIHTC Results: 7.08% vacancy rate (92.92% occupancy rate)

HOME/CDBG Results: 11.39% vacancy rate (88.61% occupancy rate)

Change from 2011 to 2012:

- LIHTC Aggregate: Down from 10.28%
- HOME/CDBG Aggregate: Down from 17%

Question 2: Amount in Operating Reserves

LIHTC Results: \$67,368

HOME/CDBG Results: \$36,431

Change from 2011 to 2012:

- LIHTC Aggregate: Up from \$53,815.22
- HOME/CDBG Aggregate: Down from \$157,920.06 (note: large outliers in 2011)

Question 3: Amount in Replacement Reserves

LIHTC Results: \$67,436

HOME/CDBG Results: \$27,771

Change from 2011 to 2012:

- LIHTC Aggregate: Up from \$62,780.75
- HOME/CDBG Aggregate: Down from \$112,560.40 (note: large outliers in 2011)

Question 4: Net Operating Income/Loss

*NOTE- See Parts III and V below for a discussion on issues with this data

LIHTC Results: \$131,310

HOME/CDBG Results: \$45,003.58 (excluding outlier that reported almost \$2,000,000 NOI)

Change from 2011 to 2012: Question not asked in 2011, so comparison cannot be completed.

Question 5: Debt Coverage Ratio

*NOTE- See Parts III and V below for a discussion on issues with this data

LIHTC Results: 1.87

HOME/CDBG Results: 0.85

Change from 2011 to 2012:

- LIHTC Aggregate: Up from 1.77
- HOME/CDBG Aggregate: Down from 1.40

Question 6: Total Accounts Payable

LIHTC Results: \$21,005

HOME/CDBG Results: \$9029

Change from 2011 to 2012:

- LIHTC Aggregate: Down from \$27,196.06
- HOME/CDBG Aggregate: Down from \$60,887.68

Question 7: Total Accounts Receivable

LIHTC Results: \$7856

HOME/CDBG Results: \$13,918

Change from 2011 to 2012:

- LIHTC Aggregate: Down from \$18,800.64
- HOME/CDBG Aggregate: Down from \$62,991.78

Question 8: Property Taxes Paid Up-to-date (Yes or No)

LIHTC Results: 98.97% Yes, 1.03% No

HOME/CDBG Results: 93.20% Yes, 6.8% No

Change from 2011 to 2012: Comparison cannot be completed, see note above.

Question 9: Property Insurance Up-to-date (Yes or No)

LIHTC Results: 99.82% Yes, 0.18% No

HOME/CDBG Results: 100% Yes, 0% No

Change from 2011 to 2012: Comparison cannot be completed, see note above.

Question 10: Anticipated Changes in Ownership (Yes or No)

LIHTC Results: 3.25% anticipated change

HOME/CDBG Results: 2.52% anticipated change

Change from 2011 to 2012: Comparison cannot be completed, see note above.

Question 11: Anticipated Changes in Management (Yes or No)

LIHTC Results: 3.25% anticipated change

HOME/CDBG Results: 1.68% anticipated change

Change from 2011 to 2012: Comparison cannot be completed, see note above.

Question 12: In Good Standing with Other Funding Sources (Yes or No)

LIHTC Results: 99.47% Yes, 0.53% No

HOME/CDBG Results: 99.15% Yes, 0.85% No

Change from 2011 to 2012: Comparison cannot be completed, see note above.

Question 13: Program Noncompliance Identified During Year (Yes or No)

LIHTC Results: 3.26% identified noncompliance during 2012 calendar year

HOME/CDBG Results: 1.68% identified noncompliance during 2012 calendar year

Change from 2011 to 2012: Comparison cannot be completed, see note above.

III: Analysis of Quantitative Questions

Overall, the 2012 responses to Questions #1-7 suggest that the data being submitted is not yet reliable. A substantial amount of submissions left several questions in this section of Exhibit D blank or answered the question(s) as “n/a”. At other times, data was provided but the information seemed unrealistic. Below is a brief analysis of each question.

The vacancy data (Question #1) is accurate, as IHCD cross-referenced the answers provided on Exhibit D with tenant data submitted for the properties. The trend shows an improvement in vacancy rates from the December 31, 2011 snapshot to December 31, 2012. Looking at the aggregate data, vacancy rates are not a major concern in the portfolio.

The operating and replacement reserve data (Questions #2 and 3) is likely reliable. The average reserves increased from 2011 to 2012. This is due not to improvements at properties, but in the increase in the sample size reviewed and the addition of some larger/newer properties that still have large reserves available.

The net operating income/loss and debt coverage ratio data (Questions #4 and 5) appear to be the most inaccurate and inconsistent data provided. IHCD is aware that different partners calculated these numbers in different ways, providing inaccurate and incomparable answers. The responses provided for debt coverage ratio ranged from -7 up to 14.8. Many of these responses were not logical based on IHCD underwriting and expectations.

The total accounts payable and total accounts receivable data (Questions #6 and 7) seemed to vary in quality. Upon a quick glance, the changes from 2011 to 2012 show drastic decreases in both figures. However, IHCD A believes the reason the numbers reported in 2011 were much higher is that many properties misunderstood how to answer the question in 2011. The question is meant to obtain the outstanding amount payable or receivable as of yearend, not the total amount paid or received throughout the year.

Possible solutions to address inaccuracies and inconsistencies in the data are addressed in Part V below.

IV: Analysis of Qualitative Questions

The 2012 responses to Questions #8-13 were encouraging. Only a small minority of properties were noted as being behind on property taxes (Question #8), behind on or lacking in property insurance (Question #9), or in bad standing with other funding sources (Question #12). However, it is somewhat concerning that 6.8% of the HOME/CDBG dataset noted being behind on paying property taxes. IHCD A has flagged all properties that answered negatively on Questions #8, 9, or 12 as potentially at-risk properties and will pay special attention to the 2013 information submitted on these properties.

Another item worth mentioning is that only 3.26% of LIHTC properties and only 1.68% of the HOME/CDBG properties noted that the owner or management had self-identified issues of noncompliance during the year. Based on experience reviewing annual reports and conducting file audits and physical inspections, IHCD A believes that a higher percentage of properties experience noncompliance during a year. IHCD A is using results from 2013 monitorings to establish a baseline on the average percent of properties and average number of units/files that have findings or concerns. Assuming the numbers are in fact higher than being reported, this means that property owners and management agents are not doing a sufficient job with internal auditing and due diligence. In other words, noncompliance exists but is not being caught through internal controls. A possible explanation is that the owners did not wish to disclose this information on the Exhibit D form. However, IHCD A does not penalize owners for noncompliance that is discovered and corrected outside of an IHCD A monitoring, so there is no need for owners to withhold this information. This area warrants further analysis once the baseline numbers are available for comparison.

V: Next Steps for Improving Data Collection

As stated in Part III above, much of the qualitative data submitted via Exhibit D appears to be inaccurate and there are inconsistencies in the way different property owners are interpreting the questions and/or performing the required calculations.

IHCD A requested public feedback on ways to improve the Exhibit D form for 2013 reporting. Specifically, the request asked if there were ways to make the questions clearer or to provide better guidance on how to complete the form. Four comments were received. Three of these comments were regarding the definition of net operating income and why property taxes are excluded from the calculation. IHCD A will be examining this question further to ensure that the definition is both correct

and clear on the 2013 form. The fourth comment requested that IHCDa collect information on the amount of property taxes paid on each property for the year.

In addition, prior to requesting public feedback, IHCDa had already identified the following tasks to help improve the quality of data:

- Clarify IHCDa's expected calculation methodology for net operating income/loss. Provide a sample calculation. This seems needed given the public feedback questioning the accuracy of the definition provided on the form, as described above.
- Clarify IHCDa's expected calculation methodology for debt coverage ratio. Provide a sample calculation.
- Clarify how to answer Questions #6 and 7 by better explaining that accounts payable and accounts receivable is looking at an outstanding snapshot as of yearend, not a cumulative amount for the year.

In addition, IHCDa is aware that a possible solution to improve the accuracy of data is to push back the deadline for submitting the Exhibit D form. Currently, the form is due on January 31st of each year to report on the previous calendar year. This deadline was established in order to align with submission of the Annual Owner Certification of Compliance which reports on program compliance issues. In order to submit the financial data by January 31st, the information in many cases is not based on final audited numbers for the year. While a new deadline will not be established for the 2013 reporting requirements, IHCDa is exploring a method to submit the Exhibit D data separate from the Owner Certification at a later point in the year.

VI: Next Steps for Using the Data

The original purpose of collecting financial information on rental properties (and thus creating Exhibit D) was twofold. First, this data in aggregate form could be useful for IHCDa's Real Estate Underwriting division to establish and understand trends statewide, by certain cities or counties, or by certain property types (e.g. family vs. senior housing). Second, on the individual property level this information is useful in identifying troubled assets.

In order to begin using the information for underwriting purposes, the following steps are necessary.

- Data submitted must be more consistent and accurate, especially regarding net operating income/loss and debt coverage ratio. The steps outlined in Part V above are an effort to improve quality of data.
- From a data analysis standpoint, for future years the operating and replacement reserve information needs to be dissected further to look at variance based on variables such as the size and age of properties. It is not particularly useful to compare the reserves at a 200 unit property to those at a 40 unit property or at a property in Year 2 to a property in Year 15.
- Similarly, the net operating income needs to be analyzed further to examine NOI on a per unit basis.

In order to begin using the information to identify trouble assets, IHCDa must finalize standards and a risk rating protocol to define what it considered “troubled.” This risk rating system must take into effect the fact that different properties must be analyzed using the same indicators but different standards. As previously discussed, one example is that it is not feasible to expect one standard for reserves across the board. What is considered an acceptable level of reserves will vary greatly depending on the size and age of a property. IHCDa’s risk rating protocol must be sophisticated enough to identify these variables when evaluating a property as either performing or troubled. This project is currently in the works.

VII: Conclusion

The asset management data collected via Exhibit D is improving, but much work still needs done in order to (1) obtain useful data and (2) transfer that data into internal decision making processes. IHCDa’s Real Estate Department is working to implement the steps outlined in Parts V and VI above in order to improve its asset management efforts.

Questions or comments about this report can be submitted to Matt Rayburn, Chief Real Estate Development Officer via mrayburn@ihcda.in.gov.